



COMMERCE COMMISSION

Terms of Reference

1171437_1 / 12796

Date: 5 April 2011
Subject: Consideration of a dairy price control inquiry

Background

1. Recent media attention has focused on high domestic milk prices. The Commission has received several calls to initiate a price control inquiry into the price of milk and was questioned by the Commerce Select Committee about whether an inquiry would be initiated. The Commission expressed a preliminary view, based on its current knowledge of the relevant markets, that there was no appropriate basis for the commencement of a Part 4 inquiry in this case. However, the Commission noted its preparedness to review this preliminary view, if evidence was presented to it. The Commission has decided to revisit this preliminary view in light of material which has recently been submitted to it.
2. An examination of the price of milk would encompass the price paid by processors for raw milk, the wholesale prices charged by processors, and the retail prices.

Scope/purpose

3. The aim of this project is to determine whether or not the Commission should, on its own initiative, hold an inquiry into the price of milk (in accordance with section 52H(1)(b) of the Commerce Act 1986). If our enquiries reveal an issue under the Dairy Industry Restructuring Act 2001, the Dairy Industry Restructuring (Raw Milk) Regulations 2001 or Part 2 of the Commerce Act, we will consider those issues separately.

Criteria for Part 4 regulation

4. Goods or services may be regulated under Part 4 of the Commerce Act only if the goods or services are supplied in a market where there is both—
 - little or no competition; and
 - little or no likelihood of a substantial increase in competition; and
 - there is scope for the exercise of substantial market power in relation to the goods or services, taking into account the effectiveness of existing regulation or arrangements (including ownership arrangements); and
 - the benefits of regulating the goods or services in meeting the purpose of Part 4 materially exceed the costs of regulation (this need not be considered unless the first three criteria are met).¹

¹ Section 52G Commerce Act 1986.

Markets

Raw milk

5. In general, raw milk is obtained either from farmers, or from Fonterra, largely under the Raw Milk Regulations. Fonterra collects about 89% of raw milk in New Zealand. Its main competitor in the domestic market, Goodman Fielder Limited, purchases raw milk from Fonterra for processing. Some smaller independent processors who produce town milk source milk from Fonterra. Due to the lack of competition at this level, the market for raw milk is regulated by the Raw Milk Regulations.
6. In order to look at ultimate retail prices, prices in the upstream markets must also be considered. An inflated milk price at this market level could affect the price of milk at other functional levels of the market. The Commission has also received complaints about how Fonterra sets the farm gate milk price, which ultimately affects other processors on two fronts: the regulated price is reliant on it; and other processors compete with that price when trying to attract farmer suppliers. The complaints allege that Fonterra is setting a notional milk price, which is anti-competitive in nature.
7. We will request that Fonterra voluntarily supplies a copy of the Milk Price Manual and its calculations, to allow an assessment of the farm gate milk price.

Town milk

8. In Decision 574, about the acquisition of Kapiti Fine Foods by Fonterra Co-operative Group Limited, the Commission cleared the acquisition, and considered that a North Island market for town milk was likely. The Commission will investigate the market shares of the providers of town milk in the North and South Islands, and test whether its previous market definition and competition analysis is still relevant.

Retail milk prices

9. There are two main retailers of milk: Foodstuffs and Progressive Enterprises. The Commission will make enquiries of both retailers. Competition at this level of the market also comes from oil companies, convenience stores, and individual dairies. Any competition concerns at this functional level of the market would manifest themselves in the prices for all products sold in supermarkets, not just milk.

Outputs

10. The Commission will look at the amount of competition at each functional level of the market related to liquid milk,² and make a decision about whether it would be appropriate to initiate a price control inquiry at any, or all, of those levels.
11. As a precursor to any inquiry, a report on the matter, providing the reasons why an inquiry would be appropriate or inappropriate, will be prepared with an expected timeframe for delivery of two months.

² We do not propose to look at wider markets for dairy products such as cheese or ice cream, as these markets also depend on the first functional level for liquid milk – the supply of raw milk.